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Economic Report

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How Bad Was It?

During the summer, the National Bureau of Economic Research, the nation's unofficial arbiter of the business cycle, declared that the recession which began two years earlier came to an end last November. Although this decision was made some seven months after the fact, it nonetheless has significant bearing for current and prospective economic and political developments. This is because it permits a comparison to be drawn between the latest recession and prior postwar declines in economic activity. In previous Economic Reports, I have discussed what I believe were the causes of the 1981-82 recession, thus I will not repeat them here. However, I do think it is useful to compare this past recession with its predecessors to see if any lessons can be learned.

The 81-82 Recession ...

The first measurement that comes to mind, of course, is length. Affixing November 1982 as the terminal date means that the 1981-82 recession was 16 months in duration. This equals the 1973-75 recession as the longest in the postwar era. Together, these two recessions were longer than any continuous decline in business activity since the 43 month slump that marked the first phase of the Great Depression (August 1929-March 1933). Naturally, the most recent recession was longer than average. The seven previous postwar declines averaged ten months in length.

Another way that recessions can be compared is in terms of depth. Two important ways of looking at this are the percentage decline in the real gross national product and in industrial production. Looked at this way, a slightly different conclusion emerges. To be sure, the 1981-82 recession comes in worse than average in terms of percentage drop in the economy. The real gross national product fell by three percent during this time compared with the average for the previous seven recessions of 2½ percent. The same is true for industrial production. From top to bottom industrial production fell by 12.3 percent in the most recent recession compared with an average decline of 10.3 percent for the previous seven cycles.

However, in neither case was the decline the worst or even tied for the worst in the postwar era. In the case of the real gross national product, the title goes to the recession that began in November 1973 and ended in March 1975. In that recession the real GNP fell by 4.9 percent—far and away the biggest drop in the postwar era. There were two other recessions whose decline in the real gross national product exceeded the one registered in 1981-82. The 1957-58 recession saw real GNP fall by 3.3 percent, while the recession of July 1953 to May 1954 registered a 3.2 percent decline in real GNP.

Looking at industrial production, one finds that the biggest drop also occurred during the 1973-75 recession. Then, output of the nation's factories, mines and utilities fell by 15.3 percent. The second biggest postwar decline in industrial production occurred during the recession of 1957-58. Although one of the shortest (eight months in duration) of the postwar era, it clearly was one of the most severe, with industrial production plunging by 13.5 percent.

Both labor and management would argue that the most recent recession was the worst in half a century. The unemployment rate, as is widely known by now, touched a postwar high of 10.8 percent in the last recession—more than three percentage points higher than the average peak jobless rate of the previous seven cycles. Employment, correspondingly, registered a greater percentage decline during the most recent recession than it did on average during the previous downturns, with manufacturing payrolls, especially in durable goods industries, suffering relatively more than other sectors.

Interestingly, the percentage increase in the number of people unemployed, 53.2 percent, was far below average and one of the smallest in the postwar era. How-

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ever, this measurement, like so many others, may have been affected by the fact that the 1981-82 recession followed almost immediately on the heels of another recession, a six month downturn occurring during the first half of 1980. The 12 months that separated the January 1980-July 1980 recession from the July 1981-November 1982 recession was the shortest in postwar history. Indeed, it was the shortest in 60 years! By the same token, the six-month recession that the NBER says occurred during first-half 1980 was the shortest of all the officially recognized recessions going back to the early 1850s. This has led many economists to conclude that the 1980 and 1981-82 recessions ought to be considered together. If so, it would produce a downturn that in many—but not all—respects would represent the worst economic decline in the United States since the Depression.

... Was One Of The Worst ...

Two measurements important to business paint an equally as gloomy picture of the most recent recession. Corporate profits normally take it on the chin during an economic decline, but this time the blow was much harder than usual. On average, corporate profits fell about 22 percent during postwar recessions. Until the latest, the biggest percentage decline in corporate profits occurred during the 1957-58 recession, when pretax earnings fell by 27 percent. The 1981-82 recession, however, saw profits plunge by more than 31 percent. And, since many businesses did not fully recover from the 1980 recession, when profits fell by 18 percent, you can see that the business sector was really hit hard. Some companies were hit so hard that they were knocked out of contention all together. Business failures during the most recent recession reached their highest levels since the depths of the Great Depression some 50 years earlier.

Another measurement deals with pervasiveness, or how many industries were affected by the decline in aggregate economic activity. As you can see from the table, the percentage of industries with falling output during a recession is normally quite large, averaging about 90 percent. But the 1981-82 recession was the first of the postwar downturns when all of the two dozen major industries regularly monitored by the NBER reported falling output.

Looking beneath the surface produces even more diverse results. For example, while output of consumer goods did fall by more than it did on average, this traced to a greater than usual decline in consumer softgoods output, rather than consumer hardgoods production. Indeed, the 15.8 percent drop in production of consumer durable goods was not only less than the 19.9 percent average decline, it was the smallest percentage decline since the recession of 1948-49. By contrast, the 1973-75 recession saw consumer durable goods output fall by nearly 30 percent. Coming in the wake of the quadrupling of world oil prices and the announcement of an embargo of Persian Gulf petroleum shipments to the United States, this was a product of long lines at gasoline stations—and a sharp decline in the demand for domestically-produced automobiles, most of which averaged less than ten miles per gallon. However, during the most recent recession, oil supplies were plentiful and their prices were declining. In addition, output of consumer durable goods had already fallen nearly 22 percent during the 1980 recession, so the level from which they began their plunge during the 1981-82 recession was obviously low to begin with.

DURATION, DEPTH AND DIFFUSION OF POST-WORLD WAR II RECESSIONS

Cycle Peak Trough	Duration In Months	Depth: Decline in Real GNP	Depth: Decline in Industrial Production	Depth: Peak Jobless Rate	Depth: Decline in Pre-Tax Profits	Depth: Lowest Operating Rate	Diffusion Index* Industrial Production
Nov 48–Oct 49	11	–1.5%	–10.1%	7.9%	–24.0%	71.7%	91.7%
Jul 53–May 54	10	–3.2	– 9.4	6.1	–23.6	78.8	87.5
Aug 57–Apr 58	8	–3.3	–13.5	7.5	–27.0	71.3	97.9
Apr 60–Feb 61	10	–1.2	– 8.6	7.1	–18.4	73.5	91.7
Dec 69–Nov 70	11	- 1.0	– 6.8	6.1	–19.8	75.9	79.2
Nov 73–Mar 75	16	–4.9	–15.3	9.0	–23.9	69.0	95.8
Jan 80–Jul 80	6	–2.3	– 8.6	7.8	–17.9	75.5	87.5
Average	10	–2.5	–10.3	7.4	–22.1	73.7	90.2
Jul 81–Nov 82	**16**	**–3.0**	**–12.3**	**10.8**	**–31.3**	**68.8**	**100.0**

*Maximum percentage of 24 industries with falling output over a six-month span.

Sources: National Bureau of Economic Research, Federal Reserve Board, Bureau of Labor Statistics, Commerce Department.

On the other hand, the drop in output of business equipment during the most recent recession was not only twice as great as average, it was equal to the worst decline in the postwar era. This can be traced to several factors. One is that capacity utilization fell to a lower point in the most recent recession than it did in any other previous postwar downturn. With nearly one-third of usable capacity lying idle, there clearly was little need for new equipment except for modernization.

Another major reason for the slump in purchases of business equipment deals with interest rates. Readers of these Economic Reports will recall that in 1980 and again in 1981 the cost of borrowing money reached astronomical levels—especially after adjusting for inflation. This made it very expensive to finance the purchase of a new machine, assembly line, factory, etc. The high level of interest rates also prompted many companies to invest in financial instruments rather than in their own business, since the rate of return was greater.

The heights to which both nominal and real interest rates reached during the most recent recession was something to behold. At 19.2 percent, the federal funds rate's peak level during the 1981-82 recession was about ten percentage points higher than the average peak funds rate of the five previous cycles. And that includes the 1980 recession, when funds topped 17 percent; excluding that cycle the 1981-82 funds rate peak was nearly 12 percentage points higher. The same can be said for the banks' prime lending rate with one important addition: at its low of 11¾ percent during the 1981-82 recession, the banks' prime lending rate was almost as high as the highest point reached during the 1973-75 recession, 12 percent.

The comparison of real interest rates is even more startling. During the six previous recessions, the real prime rate (the nominal prime rate minus the rate of inflation) averaged about two percentage points. Indeed, during both the 1973-75 recession and the 1980 recession the spread between the prime rate and the rate of inflation was negative—meaning that inflation was higher than the prime rate. In the most recent recession the real prime rate reached a peak of ten percentage points and only on two short occasions got as low as seven percentage points. As for long term rates, they also averaged about two percentage points during the six previous recessions, and turned negative during the two recessions immediately prior to the most recent one. In the most recent recession they, too, were several times higher than historical average. I might note that real long term rates are even higher today than they were during the last recession.

... But It Did Slow Inflation Markedly

Not all comparisons are negative. Indeed, the very severity of the 1981-82 recession produced one extremely favorable result: a marked reduction in the rate of inflation. Of course, recessions usually pull down the rate of inflation by reducing the ability of both business and labor to raise prices and wages owing to weak demands. But the extent to which inflation was curbed in the current recession is unprecedented in recent economic history. For example, the consumer price index was rising at a 12-month clip of close to 11 percent at the start of the last recession and at a year-over-year pace of only five percent 16 months later. What is more, inflation subsequently slowed to a 12-month rise of less than 2½ percent by June 1983—the smallest 12-month rise in 16 years. In fact, in the three months immediately following the end of the last recession consumer prices actually fell by an annual rate of 1.2 percent, the first three-month decline since 1954!

Thus inflation, which was running much higher than past experience as the U.S. entered the 1981-82 recession has now been brought back to rates of the 1960s. It may not be stable prices, but by the experience of the 1970s and the early part of this decade it sure feels a lot better. What is more, I do not detect a resurgence of inflation anytime soon—notwithstanding trends in the money supply and food commodities prices. This is because the still-high level of unemployment combined with the still-low rate of capacity utilization continues to keep pressure on wages and prices, making it difficult for both labor and management to ask for more. In their roles as consumers, people remain extremely reluctant to pay higher prices for anything—whether business goods or consumption items—and continue to go out of their way to patronize those who hold the line on prices, or offer discounts.

If we can keep this up, then the very severe recession just concluded will have left us with one positive legacy, and a very important one at that: a return to our historically low rate of inflation. ■

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